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SUBJECT: INVESTMENT CLIMATE STATEMENT 2007 - ITALY, PART I

REF: 06 STATE 178303

11. This is part one of a two-part cable on Italy's investment climate.

12. SUMMARY: While the Government of Italy (GOI) continues to court foreign investors, the GOI still needs to enact economic reforms and take other steps to ensure a more welcoming investment climate. Current positives include: Parliament passed financial market oversight reform in 2005, along with a more efficient bankruptcy law; also, GOI officials, including Italian Minister for International Trade and European Affairs Emma Bonino, have recently visited the U.S. to encourage American investment in Italy. However, historical stumbling blocks that discourage foreign investment persist -- namely, an inefficient delivery of public services, a slow judicial system, and bureaucratic red tape. Since Italy's national elections in April 2006 brought to power Prime Minister Prodi's center-left coalition, the GOI met EU demands to put its fiscal house in order, but has refrained from tackling significant economic reform. However, Italy remains competitive with many other developed countries in offering opportunities for investment.

13. Italy has a diverse economy, the sixth largest market economy in the world. Small- and medium-sized firms dominate the Italian economy. Germany, France, and the U.S. remain Italy's most important export markets. Industrial activity is concentrated in the north -- one of the most industrialized and prosperous areas in Europe. By contrast, the center and the south are less developed, with unemployment in some areas three times that of the north and per capita incomes substantially lower. End summary.

#### OPENNESS TO FOREIGN INVESTMENT

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14. Foreign direct investment in Italy is generally welcomed and encouraged. The previous Berlusconi Government (2000-2005), supported by major labor and trade groups, launched initiatives to identify and address obstacles to investing in Italy. While PM Prodi has also voiced strong support for attracting foreign investment and trimming bureaucratic obstacles to economic activity, members of his coalition have so shown little positive action. For example, members of Prodi's coalition have prevented a 25 billion euro merger between the Spanish company Abertis and an Italian toll-road operator. The GOI's opposition to the so-called "Abertis-autostrade" deal appears to indicate an unwillingness to allow foreign investment and/or control in large Italian and government-controlled companies. However, GOI officials, among them Italian Minister for International Trade and European Affairs Emma Bonino, have recently traveled to the U.S. and made efforts to reach

out to U.S. investors and discuss the future of foreign investment in Italy.

¶15. As an EU Member State, Italy is bound by EU treaties and legislation, some of which have an impact on business investment. As specified under the right of establishment set forth in the EU treaty (1957 Treaty of Rome), Italy provides national treatment to foreign investors established in Italy or in another EU member state, except in a few instances. Exceptions include limited access to government subsidies for the film industry, added capital requirements for banks domiciled in non-EU member countries, and restrictions on non-EU-based airlines operating domestic routes. Italy also has restrictions in the shipping sector.

¶16. The GOI does have the authority to restrict foreign investment in some cases. The government can block mergers involving foreign firms for "reasons essential to the national economy" or if the home government of the foreign firm applies discriminatory measures against Italian firms. Industrial sectors such as defense and aircraft manufacturing, are either closely regulated or are off limits to foreign investors. EU and Italian anti-trust laws give EU and Italian authorities the right to review mergers and acquisitions over a certain financial threshold.

¶17. Foreign investors are not prevented from investing in firms to be privatized, except in the defense sector. Privatization strategies have often entailed the GOI establishing a core group of shareholders who agree to keep their shares for a minimum period or retain a "golden share" (a modest government stake, but with controlling authority). Italy is the only EU member country to keep wide-ranging "golden share" regimes for privatized companies. According to EU data, there are 20 EU-based companies in which Member States hold a golden share -- five of these are Italian (Eni,

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Enel, Finmeccanica, Terna, and Telecom Italia).

¶18. The Italian Trade Commission (ICE) reported in January 2007 that 7,200 foreign companies operate in Italy, employing almost one million workers, and that the stock of foreign investment in Italy equals 12 percent of GDP (far less than many EU nations). Approximately 77 percent of foreign companies operating in Italy are located in the north, with the Lombardy Region alone hosting 46 percent. The ICE study cited as key obstacles to foreign investment: labor taxes, lack of labor flexibility, red tape, and corporate taxes.

¶19. The 2006 World Competitive Survey by the World Economic Forum ranked Italy 42nd among the 124 countries surveyed; Italy's economy was judged only better than those of Poland and Greece among the 25 EU Member States. (Note: Italy was also ranked higher than Romania and Bulgaria -- two new EU member states as of January 1, 2007.)

#### CONVERSION AND TRANSFER POLICIES

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¶10. In accordance with EU directives, Italy has no foreign exchange controls. There are no restrictions on currency transfers, only reporting requirements. Banks are required to report any transaction over 12,500 euro (USD 16,000) due to money laundering and terrorism financing concerns. Profits, transfers, payments, and currency transfers may be freely repatriated. Residents and non-residents may hold foreign exchange accounts.

#### EXPROPRIATION AND COMPENSATION

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¶11. The Italian constitution permits expropriation of private property for "public purposes." Compensation is guaranteed and must adequately compensate the proprietor for losses. However, lenders are not covered by the same constitutional guarantee as proprietors. Italy's Constitution also authorizes the nationalization of enterprises that provide essential public services or are deemed "indispensable" to the national economy. There exist a few

long-standing disputes in Italy involving U.S. citizens who assert that municipal governments unjustly expropriated their real property or inadequately compensated them. However, this does not reflect any GOI discrimination against U.S. investments, companies, or representatives in any specific sector of activity.

#### DISPUTE SETTLEMENT

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¶12. Italy's judicial system may serve as a deterrent to foreign investors, since civil trials average seven years in length. U.S. investors in Italy can choose among different means of dispute resolution. The method chosen should be specifically set forth in a contract.

¶13. Though notoriously slow, the Italian legal system is consistent with generally recognized principles of international law, with provisions for enforcing property and contractual rights. Italy has a written and consistently applied commercial and bankruptcy law. While the Italian judiciary is considered independent of the government, Italian judges may engage in political partisanship. Italian courts accept and enforce foreign judgments only upon request.

¶14. At the end of 2005, the GOI passed a new bankruptcy regulation that reforms earlier (1942) bankruptcy regulation. The new regulation -- analogous to U.S. Chapter 11 restructuring -- provides more flexibility between parties to reach a solution before declaring bankruptcy. The judicial role in bankruptcy procedures has been drastically limited to simplify and speed up the process. The new regulation went into effect in 2006.

¶15. Italy is a member of the World Bank's International Center for the Settlement of Investment Disputes (ICSID). Italy has signed and ratified the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, and is a signatory of the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards.

#### PERFORMANCE REQUIREMENTS/INCENTIVES

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¶16. The GOI is in compliance with WTO Trade-Related Investment Measures (TRIMS) obligations. Foreign investors face specific performance requirements only in the telecommunications sector. However, this has not deterred foreign investment in telecommunications. For example, in 2005 Weather Investments, owned by an Egyptian financier, bought Wind, Italy's second largest telecommunications company; Vodafone, Italy's second largest mobile operator, is also foreign-controlled.

¶17. The GOI offers incentives to encourage private sector investment in economically depressed areas, particularly in southern Italy. (For more details, please visit the website: [www.InvestinItaly.com](http://www.InvestinItaly.com).) The Ministry of Universities and Research has identified, funded, and signed Framework Program Agreements with eleven "Technology Districts" and public-private joint laboratories focused on strategic sectors. Technology Districts, created to facilitate cooperation between public and private researchers and venture capitalists, serve to support research and development of key technology, strengthen industrial research activities, and promote innovative behavior in small- and medium-sized enterprises.

¶18. The Italian tax system does not discriminate between foreign and domestic investors. In 2003, the Italian Parliament passed a law to broadly reform the tax system (Legislative Decree No. 344). The new tax law entered into force January 1, 2004 and remains largely unchanged since the GOI's 2006 budget bill. For corporations, the main characteristics of the reformed tax system are:

-- The corporate income tax is 33 percent.

-- Under certain circumstances, partial tax exemption for capital gains and losses from participation in Italian and foreign corporations holds (so-called "participation exemption").

-- Abolishment of the dividend tax credit, and introduction of a 95 percent exemption on dividend distributions (provided dividends are distributed to corporations).

-- Introduction of a group taxation regime for Italian/foreign corporations belonging to the same group to consolidate their tax base at the level of the Italian parent.

-- Interest due on financing provided by qualified shareholders and by controlled companies are not deductible when financing exceeds certain limits -- e.g., when financing exceeds four times the share of company net assets. These provisions are labeled "thin capitalization," a debt/equity requirement to maintain minimal capital requirements for Italian corporations.

#### RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT

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¶19. There is no limitation in the Italian constitution or civil law on the right to private ownership and establishment.

#### PROTECTION OF PROPERTY RIGHTS

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¶20. Enforcement of Intellectual Property Rights (IPR) remains a serious problem in Italy and falls below the standards of other developed Western European countries. Relatively few IPR cases are brought to trial. Even when prosecutors win a conviction, judges are generally reluctant to sentence offenders to prison. The Customs Police still actively seizes pirated and counterfeit goods along the border and Italy's national financial police force, the Guardia di Finanza, has grown steadily more effective in IPR enforcement. However, many local governments do little to stop the sale of pirated and counterfeit goods by street vendors. In April 2005, Italy enacted a new law empowering police to fine consumers of pirated and counterfeit items up to 10,000 euro. In 2006, several municipalities, such as Florence, began to undertake aggressive publicity campaigns to alert Italians and foreign tourists of the new law.

¶21. Italy is a member of the Paris Union International Convention for the Protection of Industrial Property (patents and trademarks) to which the United States and about 85 other countries adhere. U.S. citizens generally receive national treatment in acquiring and maintaining patent and trademark protection in Italy. After filing a patent application in the United States, a U.S. citizen is entitled to a 12-month period within which to file a corresponding application in Italy and receive rights of priority. Patents are granted for 20 years from the effective filing date of application and are transferable. U.S. authors can obtain copyright protection

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in Italy for their work first copyrighted in the United States, merely by placing on the work, their name, date of first publication, and the symbol (c).

¶22. In 2000, the Italian Parliament enacted a long-awaited "anti-piracy" law, providing for higher criminal penalties, including prison sentences of up to four years, for copyright (IPR) violations. Largely because of the enactment of this law (thought to be among the best in the EU), Italy has since been moved from the U.S. Trade Representatives Special 301 IPR "Priority Watch List" to the "Watch List." Italy remains on the Watch List, however, because of its continuing failure to enforce this and other IPR protection laws.

¶23. Copyrighted works sold in Italy generally must bear a sticker issued by SIAE, a royalty collection agency operating under authority from the Ministry of Culture. While the music and film industries have been so far largely satisfied with the stickering system, software industry associations have complained the system remains overly burdensome and fails to provide adequate protection from piracy. In January 2003, the Italian government approved

exemptions for business software from the SIAE sticker requirement.

¶24. In 2005, Italy's Parliament passed legislation that some copyright industry associations believe weakens Italy's IPR legal framework. Italy's Internet piracy statute was revised to reduce criminal sanctions for on-line piracy conducted without a profit motive. While illegal file sharing technically remains a crime, only those who engage in piracy for monetary gain now face jail time, while all others face administrative fines only. Parliament also passed a broad legal reform bill in 2005 (known as the "ex-Cirielli" law), which shortened the period after which criminal cases pending trial are automatically dismissed. Separately, a broad amnesty was passed in 2006, which IP industries believe voided many sentences and criminal prosecutions against IPR pirates.

#### TRANSPARENCY OF THE REGULATORY SYSTEM

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¶25. In an effort to improve accountability and competition in the wake of the 2003-04 dairy firm Parmalat's collapse and scandal, Italy's Parliament approved a law in December 2005 to overhaul the Bank of Italy and improve corporate governance and oversight. Italy also is subject to single market directives mandated by the EU, which are intended to harmonize regulatory regimes among EU countries.

¶26. The 2007 "Index of Economic Freedom," published by the Wall Street Journal and Heritage Foundation, ranked Italy as having "the world's 60th freest economy." The study highlighted government interference, corruption, and a slow court system as contributing to Italy's ranking below less developed nations such as Uganda, Belize, and Jamaica. (Note: Italy slid from 26th place in 2004, to 42nd in 2005.)

¶27. According to a 2004 World Bank study, an entrepreneur wishing to start a business in Italy must follow 16 procedures, spend an average of 62 days, and pay around USD 5,000. The study found that it costs more to open a business in Italy than anywhere else in Europe, with the exceptions of Greece and Austria. In early 2007, PM Prodi announced that the GOI will seek to create a business-friendly environment where it would be possible to "open a business in a day."

#### EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT

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¶28. Financial resources flow relatively freely in Italian financial markets and credit is allocated on market terms. Foreign participation in Italian capital markets is not restricted; foreign investors are able to get credit on local markets and have access to a variety of credit instruments. The Italian stock exchange ("Borsa Italiana") has fewer than 300 companies. In recent years, Borsa Italiana established two new segments of the market devoted to smaller companies: "STAR" and "Mercato Expandi," launched in 2001 and 2003, respectively. However, despite this effort, the number of listed companies on the Borsa continues to decrease.

¶29. Financial services companies incorporated in another EU member state may offer investment services in Italy without establishing a local presence. U.S. and other firms based in non-EU member states may operate under authorization from Italian Companies and Stock

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Exchange Commission (CONSOB), the oversight authority for securities markets, corporate governance, and company audits.

¶30. Previously, Italian government bonds absorbed a large share of available domestic investment. However, this share declined as interest rates on those bonds dropped during Italy's preparation for the EU economic and monetary union. Even with lower yields, Italian government bonds are considered a safe haven for domestic investors burned by defaults on Argentinean, as well as Parmalat and Cirio, bonds.

## BANKING

¶31. The Italian banking sector remains sound, as the improvement in the quality of bank lending continued throughout 2006. The banking sector in the last decade has undergone significant consolidation, with about 60 percent of total Italian banking assets involved. From 1996 to 2006, mergers and acquisitions involved 349 banks. Recently, Intesa and San Paolo-IMI boards approved a proposed merger. The new banking group would be Italy's largest bank in terms of property and staff, though second to Unicredito in terms of assets. The Intesa and San Paolo-IMI approval follows Central Bank Governor Draghi's appeal to speed up bank consolidations. Currently, the country's largest banks are: Unicredito Italiano, Intesa, San Paolo-IMI, Capitalia, Banca Nazionale del Lavoro (since May 2006 fully controlled by the French group BNL Paribas), and Monte dei Paschi di Siena. The total assets of Italy's six largest banks are equal to 54.6 percent of total assets.

¶32. Retail banking fees in Italy are the highest among EU members. For example, fees for basic account payment services are eight times higher in Italy than in those EU member states with the lowest fees for service.

¶33. Since his appointment as Bank of Italy Governor, Mario Draghi has stated a clear preference for increased competition in Italian credit and banking markets. Draghi has urged Italian banks to discard their "strategic inertness" and become more competitive by cutting exceptionally high transaction charges. Draghi believes that domestic banking consolidation has been too slow and that Italian banks should proactively merge among themselves to ward off foreign bank acquisition. Draghi has publicly stated that, while "patriotism is a virtue, it must be practiced under set rules, which these days are European, and not protectionist."

¶34. Authorization by the Bank of Italy is required before acquiring more than five percent of a financial institution's capital or gaining effective control of a financial institution, regardless of the amount of capital acquired. Non-bank companies (either Italian or foreign) may not acquire more than 15 percent of a bank's capital. Complex cross-shareholding has often been used to fight off takeover attempts in the financial sector. In late 2005, the Dutch Bank ABN-AMRO obtained complete control of an Italian medium-sized bank, Banca Antonveneta; while in May 2006, the French banking group BNP Paribas acquired full control of Banca Nazionale del Lavoro, Italy's fourth largest bank.

## POLITICAL VIOLENCE

¶35. Political violence is a low threat to foreign investments in Italy.

## CORRUPTION

¶36. Italy is a signatory to the 1997 OECD Convention on Combating Bribery, ratified in September 2000. Italy has signed, but not ratified, the United Nations Convention Against Corruption, which was adopted in 2003 and came into force on December 14, 2005.

¶37. Transparency International's Corruption Perceptions Index 2006 ranked Italy the 45th least corrupt country in the world, down from its 2005 ranking of 40th.

¶38. In January 2003, Italy enacted a law creating a High Commissioner to prevent and combat bribery within public administration. Corruption is punishable under Italian law. As in all judicial processes, much discretion regarding punishment is left to the presiding judge. Most corruption in the recent past has

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involved government procurement or bribes to tax authorities.

Bribes are not considered deductible business expenses under Italian tax law.

139. END PART ONE OF CABLE. PART TWO FOLLOWS SEPTTEL.

SPOGLI